

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-130848-11

Date:

January 06, 2012

LEGEND

X =

Y =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Shareholder1 =

Shareholder2 =

Shareholder3 =

Shareholder4 =

a =

Dear _____ :

This responds to a letter dated July 21, 2011, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted and representations made by Shareholder2, the president of X, X is a corporation incorporated under the laws of State on Date1. X elected to be an S corporation effective on Date1. The initial shareholders of X were Shareholder1 and Shareholder2. On Date2, Shareholder3 became a shareholder. On Date3, X issued a additional shares to Shareholder2 for no consideration. Also on Date3, X issued shares to Shareholder4 pursuant to a merger transaction. The shares issued to Shareholder4 were subject to forfeiture if certain requirements were not met. The shares issued to Shareholder4 were held in trust by X. The trust was treated as a trust described in § 1361(c)(2)(A)(i). Accordingly, X treated Shareholder4 as the shareholder with respect to the shares held in trust as of Date3 and Shareholder4 also treated himself as the shareholder with respect to the shares of stock held in trust. Additionally, on Date3 X and its shareholders entered into a tax indemnification agreement under which X was obligated to reimburse its shareholders for any unanticipated tax liabilities arising from the merger. No payments were ever made pursuant to this provision.

On Date4, X entered into an agreement which changed the relative ownership of X among its four shareholders. No consideration was given for these changes.

On Date5, X made disproportionate distributions to its shareholders of X's ownership of Y. However, X represents that, as of Date5, Y was an inactive business with no assets or value.

On Date6, stock of X was transferred to an ineligible shareholder, causing X to no longer be eligible to be an S corporation.

X is concerned that when it engaged in the above transactions, it may have inadvertently created a second class of stock and terminated its S corporation election. X seeks a ruling that X will be treated as an S corporation from Date3 to Date6.

X represents that neither X nor its shareholders knew that any of the above transactions could potentially terminate X's S corporation election. X and its

shareholders have consistently treated X as an S corporation and agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that for purposes of subchapter S, the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides, in part, that a corporation that has more than one class of stock does not qualify as a small business corporation. Except as provided in § 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock.

Section 1.1361-1(l)(2)(i) provides, in part, that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the representations made and the information submitted, we conclude that if X's S corporation election terminated because X had more than one class of stock due to the stock issuances, disproportionate distributions, or tax indemnity agreement, such termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation from Date3 until Date6, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction engaged in by X and its shareholders from Date3 to Date6. Specifically, we express or imply no opinion regarding the appropriate Federal tax effects of any stock issuances, transfers, or disproportionate distributions engaged in by X and its shareholders. We also specifically express or imply no opinion regarding the tax treatment of the sale of the stock of X to the ineligible shareholder on Date6, or whether X is otherwise eligible to be treated as an S corporation.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Faith P. Colson

Faith P. Colson

Senior Counsel, Branch 1

Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for § 6110 purposes